Mortgage Insurance Companies of America

August 1, 2011

Office of the Comptroller of the Currency (OCC)
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0002 /
RIN 1557-AD40

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Elizabeth M. Murphy, Secretary
File No. S7-14-11 / RIN 3235-AK96

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Jennifer J. Johnson, Secretary
Docket No. R-1411 / RIN 7100-AD70

Federal Housing Finance Agency
1700 G Street, NW, Fourth Floor
Washington, DC 20552
Attn: Alfred M. Pollard, General Counsel
Attn: Comments / RIN 2590-AA43

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: Robert E. Feldman, Executive Secretary
Attention: Comments / RIN 3064-AD74

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
Docket FR 5504-P-01 / RIN 2501-AD53

Subject: **<u>Credit Risk Retention</u>**

Ladies and Gentlemen:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the notice of proposed rulemaking (NPR)[1] issued to implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[2] Our comments will focus on the exemption from risk retention for qualified residential mortgages (QRMs) and other issues related to the residential mortgage asset

[1] Interagency Proposed Rule, *Credit Risk Retention*, 76 Fed. Reg. 24090 (Apr. 29, 2011) *available at* http://edocket.access.gpo.gov/2011/pdf/2011-8364.pdf. The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Securities and Exchange Commission (SEC), Department of Housing and Urban Development (HUD) and Federal Housing Finance Agency (FHFA) are collectively referred to herein as "the agencies" in this response.
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

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category, especially those which relate to the essential role of private mortgage insurance (MI) in the US housing markets.[3]

MICA provides this response for two reasons. First, MICA represents the US MI industry and thus has a longstanding interest in encouraging maintenance of healthy primary and secondary markets for residential mortgage loans. Since 1957 the MI industry has been an integral part of the housing finance industry, helping more than 25 million families buy homes, many of them first-time buyers or families moving to take a better job or embrace new opportunities. Under the proposed QRM definition, millions of similarly situated homeowners will face unwarranted higher mortgage finance costs or lose access to credit altogether, and investors will not benefit from the reduced default frequency and loss severity provided by MI. MICA proposes solutions that increase investor confidence in housing finance, facilitate the restart of securitization markets and maximize consumer choice by encouraging the origination of prudently underwritten, sustainable mortgages.

Second, the NPR discourages use of MI. Throughout the ongoing housing downturn MICA's members have continued to pay valid claims, identify fraudulent behavior in the market and provide underwriting capacity and private capital support for new mortgage lending. MI also has reduced the cost to taxpayers resulting from the collapse of the government-sponsored enterprises (GSEs). Risk retention is intended to promote investment in well underwritten, stable residential mortgages and not to decrease consumer choice or increase investor risk. MICA explains how the use of MI increases consumer choice by providing a responsible alternative to Government mortgage insurance programs and decreases investor risk by providing an independent source of underwriting expertise and a well-regulated source of credit risk transfer.

Executive Summary

MICA makes the following recommendations, which are supported by analytic work and discussed in detail in this response.

- <u>Expand QRM</u> – The QRM definition in the NPR is too narrow. It increases the cost and decreases the availability of credit for a large portion of creditworthy borrowers. The data clearly demonstrate that QRM can be expanded to

[3] This comment letter addresses questions 79, 80, 81, 96-106, 108, 110, 111, 113, 120, 123, 143-145, 147 and 162. Each Section identifies the questions specifically addressed therein. The use of the term "MI" throughout is intended to mean "qualified MI", as explained by Section VI below.

include a greater number of prudently underwritten loans, furthering the interests of investors and consumers alike. MICA's proposed definition increases the pool of borrowers that will be able to access QRM loans, consistent with Dodd-Frank's legislative history and eminently defensible on public policy grounds. Specifically, MICA proposes revising the definition of QRM to include loans with a maximum (1) combined loan-to-value (CLTV) ratio of 97% for both purchase and rate and term refinance loans, and (2) a back-end debt-to-income (DTI) ratio of 45%. High LTV loans (those with a CLTV greater than 80%) should have MI as well, which reduces both the frequency of default and loss given default, or severity (*i.e.*, credit risk to investors). MICA estimates the proposed expansion of the QRM definition will increase the number of eligible QRM loans by more than 40% without increasing default risk materially.[4]

Requiring MI on high LTV loans assures borrowers a better chance of staying in their home because MI companies also have a strong interest in preventing defaults, encouraging defaulted loans to "cure" (or become non-delinquent) and reducing foreclosures – foreclosure and loss is the MI claim trigger. MI use also promotes "skin in the game," not only for the MI company (which has its own capital at risk in a first loss position), but also for the lender as a result of the MI companies holding the lender accountable for the integrity of their origination and servicing processes – thus protecting the investor. MICA's Proposed Expanded QRM definition, which includes greater borrower eligibility but expects default performance better than historical results for either the conventional private or Government-insured markets, achieves the Congressional intent underlying the QRM concept. Because FHA loans are exempt from risk retention, expanding QRM as MICA proposes is necessary to ensure a robust private insurance market for high LTV loans.

- <u>Exempt all mortgages backed by MI from risk retention</u> – MI-insured loans should be included in the QRM (as

[4] MICA's proposal increases eligibility from 17% to 25% (a 46% increase) for loans originated from 2001-2010, and from 30% to 43% (a 45% increase) for loans originated in 2009 and 2010 – two years in which underwriting standards were exceptionally tight - while only increasing the estimated default rate from 0.81% to 1.19% (vs. 5.13% for all conventional loans) for loans originated over a similar time period (2001-2008).

recommended above), but loans insured by MI should be exempt from any risk retention requirement as well to ensure parity of privately insured loans with loans insured by Government mortgage insurance/guarantee programs. Congress exempted loans insured by the FHA and other Government programs from risk retention in Dodd-Frank. A failure to exempt privately insured loans in the final risk retention regulation will create a permanent market advantage for Government mortgage insurance/guarantee programs over privately insured loans. Virtually all loans eligible for FHA insurance and not meeting the final QRM definition (*i.e.,* non-QRM loans) will be insured by FHA and sold through GNMA, another Government guarantee program, even though MI encourages better incentive alignment than its Government counterpart. Thus, without creation of an exemption for MI-insured loans, an intended 5% risk retention requirement for private securitizations likely will result in 100% risk retention by Government entities, at taxpayer risk and possible expense. Both Congress and the Administration have expressed interest in reducing the role of the Government in home finance. Creating an MI exemption will further these policy objectives.

- <u>Include MI as a permissible form of risk retention for non-QRM Loans</u> – Congress expressly provided for third parties to be treated as "risk retainers" in Dodd-Frank. Indeed, both the Treasury and Federal Reserve raised the possibility of third party credit enhancement providers as "risk retainers" in their reports on risk retention required by Dodd-Frank. A first loss provider like MI has sufficient skin in the game to satisfy the incentive alignment with originators, securitizers and investors envisioned by Congress in the construction of Section 941 and thus should be considered as a permissible form of risk retention. A detailed description of the current regulatory and capital structure of the private MI industry is provided to support this point.

- <u>Maintain GSE exemption as proposed</u> – MICA agrees that the NPR's proposed exemption of GSE securities from risk retention while these entities are operating under conservatorship provides much needed stability to the current mortgage market.

- <u>Hedging restrictions should be clarified</u> – The NPR's proposed restrictions on hedging or transferring retained credit risk are generally appropriate. MICA believes the Agencies should clarify the intended purpose of the hedging/transfer restrictions as being the promotion of positive incentive effects. To that end, MICA proposes that the Agencies require a documented justification or preapproval for any hedge or transfer proposed, and that any hedging or transfer activity be subject to anti-abuse standards.

- Make all related agency analytics, research, and reports public – Given the importance of credit risk retention issue to the issue of restarting private securitization markets, MICA urges the agencies to make public all of the analytics, research and reports upon which conclusions related to the QRM and the treatment of MI are based in the spirit of Executive Orders 12866,[5] 13563[6] and 13579,[7] and the recent skepticism shown regarding cost/benefit analysis done by the agencies in other financial regulatory matters.[8]

I. Congressional Intent Regarding QRM and the Role of MI

This portion of the MICA response along with sections II and III below are directed to Question 111 of the NPR.

The legislative history behind the formulation of the QRM definition makes clear that loans with down payments of less than 20 percent were contemplated by Congress as qualifying for inclusion and MI was to be considered as the primary mechanism for mitigating default risk on low down payment loans included in the QRM.

The QRM definition in the NPR is inconsistent with the legislative history of Dodd-Frank in two ways:

- First, the legislative history shows that Congress "was seeking a broad exemption that would include almost all well underwritten mortgage loans that complied with pre-boom

[5] Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993).
[6] Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011).
[7] Exec. Order No. 13,579, 76 Fed. Reg. 41,587 (July 14, 2011).
[8] See, e.g., Business Roundtable et al v Securities and Exchange Commission, No. 10-1305 (DC Cir., July 22, 2011), available at http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf.

standards."[9] Indeed, when efforts were made to include a minimum five percent down payment requirement for loans in lieu of a risk retention requirement, these efforts were defeated "in large part because of concern that a 5 percent down payment requirement was viewed as too restrictive."[10] The expressed concern at the time was that these and other requirements would have negative consequences "for first-time homebuyers, minority home buyers, and others" seeking to become homeowners. Congress believed that properly underwritten low down payment loans performed well, and borrowers should not be discouraged by the establishment of a minimum down payment requirement.[11]

- Second, the QRM amendment approved by the Senate made clear that the purpose of the amendment was to encourage the return to well underwritten mortgages, where there "is equity of 20 percent in every loan, either through a down payment **<u>or if the down payment is less than 20 percent, having mortgage insurance</u>**."[12] The legislative history is clear that Congress rejected a hard-wired minimum down payment requirement and expected MI to be used for loans with less than 20 percent down payment.

Thus, the QRM definition should be revised to be consistent with Congressional intent regarding risk retention in the residential mortgage asset category.

II. QRM Can be Expanded to be More Inclusive and Still Perform Well Within Appropriate Levels of Performance

This portion of the MICA response is directed to Questions 106, 108, 110, 111, 113, 120, 123, 143-145, 147, 162 of the NPR.

A. Proposed Revision to QRM

Historical loan performance data demonstrate that QRMs can be defined far more inclusively than the agencies are proposing while still performing at acceptable default levels. MICA thus urges the agencies to revise the definition of QRM to include loans with CLTVs of up to

[9] Ray Natter, *What Was the Legislative Intent behind the QRM?* Barnett Sivon & Natter, Our Perspectives, June 2011, p. 2. See Appendix 1.
[10] Ibid.
[11] Statement of Senator Dodd against the amendment of Senator Corker 156 Congressional Record S3518 and S3520 (May 11, 2010) as referenced in Natter, p.2,
[12] Natter, Op. Cit., p. 5. (Emphasis supplied).

97% (provided that loans with CLTVs above 80% have MI (or other comparable insurance or credit enhancement)) and back-end DTIs of up to 45% (the " Proposed Expanded QRM").[13] The Proposed Expanded QRM would increase the number of borrowers who would have access to a QRM, including a greater percentage of low to moderate income, minority and first-time home buyers, but still result in loans that would perform well under even the most conservative performance benchmark.[14] In other words, the Proposed Expanded QRM is consistent with the legislative history of Dodd-Frank regarding the QRM provision. The NPR QRM and alternative QRM definitions are not.

B. QRM Performance

The narrow approach taken by the agencies is not warranted based on loan performance. An analysis of over 43 million first lien residential mortgage loans originated from 2001 – 2008 contained in the CoreLogic Servicing Database demonstrates that loans with LTVs up to 97% and DTIs up to 45% perform well even under severe economic stress and should be included in the definition of QRM.[15] MICA analyzed the performance of loans that would have satisfied the agency QRM definition, the agency alternative QRM definition and MICA's Proposed Expanded QRM definition.[16] The loan terms of each definition are set forth in the table below:

[13] The Agencies' Proposal includes a front-end DTI (the ratio of monthly mortgage payments to monthly gross income) and a back-end DTI (the ratio of total monthly scheduled debt to monthly gross income). MICA recommends that the QRM not include a front-end DTI requirement. Should the Agencies determine that a front-end DTI is appropriate, however, MICA recommends that it be set at a level that that corresponds to a 45% back-end DTI. As a general rule, front-end DTIs are typically six percentage points less than comparable back-end DTIs.

[14] Based on analysis of over 43 million loans originated from 2001 - 2008 with an aggregate principal amount of approximately $8.8 trillion included in the CoreLogic Servicing Database.

[15] The analysis assumes that any definition of QRM adopted by the agencies will include only fully documented, fully amortizing loans and, in the case of loans with LTVs greater than 80%, MI.

[16] The CoreLogic Servicing Database does not include front end ratios, so the analysis was run with only back end ratios. The impact of a 3% cap on points and fees was estimated based on aggregate, state-by-state data provided by a national mortgage lender because the CoreLogic Servicing Database does not include detail on points and fees. The CoreLogic Servicing Database does not include derogatory factors, so for analytical purposes, a 690 FICO score was used as a proxy for the proposed derogatory factors.

Terms and Features

	Agency QRM	Agency Alternative QRM	Proposed Expanded QRM
Front DTI	28	28 Arm/33 Fixed	**N/A**
Back DTI	36	38 Arm/41 Fixed	**45**
Purchase CLTV/piggyback	80%/No	90%/Yes	**97%/No**
Refinance CLTV/piggyback	75%/Yes	90%/Yes	**97%/No**
Cash CLTV/piggyback	70%/Yes	75%/Yes	85%/No
Negative Amortization	No	No	No
Points and Fees	3% Cap	3% Cap	3% Cap
Interest Only	No	No	No
Balloons	No	No	No
Prepay Penalty	No	No	No
ARM Margins	2/2/6	2/2/6	2/2/6
ARM Product	All	All	All
Credit	690*	690*	690*
Max Term	30yr	30yr	30yr
Occupancy	Primary	Primary	Primary
Documentation	Full	Full	Full
MI Requirement >80 LTV	n/a	MI or Piggy back	**Yes**

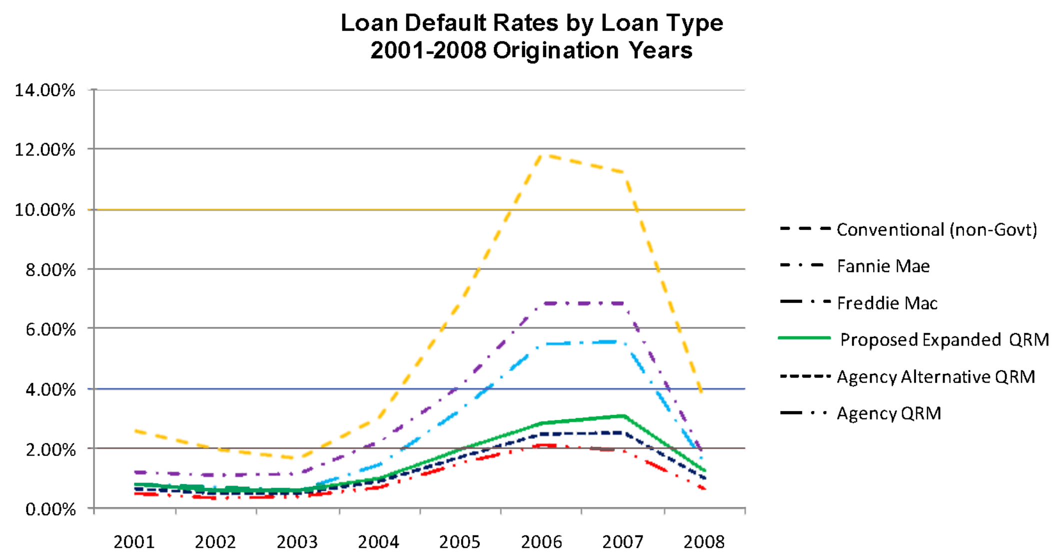
*690 FICO score is used as a proxy for the credit history factors included in the Agencies' Proposal.

The graph below compares cumulative default rates for loans that would satisfy the definitions of agency QRM, agency alternative QRM, the GSEs, all conventional loans (*i.e.*, loans not guaranteed by a Government program), and the Proposed Expanded QRM.[17] The data clearly show that the QRM definition can be broadened significantly while still performing within acceptable ranges. The default rate for the agency QRMs is 0.81%, 1.02% for the agency alternative, and 1.19% for the MICA Proposed Expanded QRM.[18] All three options perform materially better than conventional loans and loans purchased by Fannie Mae and Freddie Mac, which experienced average default rates of 5.13%, 2.83% and 2.23% respectively. MICA's *Proposed Expanded QRM, with its broader reach than the agency QRM or*

[17] Source: for conventional loans, CoreLogic Servicing Database 2001 – 2008 originations; for Fannie Mae and Freddie Mac loans, first quarter 2011 earnings releases available at http://www.fanniemae.com/ir/pdf/sec/2011/q1credit_summary.pdf and http://www.freddiemac.com/investors/er/pdf/supplement_1q11.pdf, respectively. Conventional loans are all loans other than those insured or guaranteed by a Federal agency.

[18] Default rate is the percentage of loans originated that upon termination were in foreclosure or "REO" (real estate owned) status or were 90 days or more delinquent.

alternative QRM definitions, still performs 54% better than GSE loans and 77% better than conventional loans.



Detailed data reflected in the graph are set forth in the table below:

Loan Default Rates by Loan Type
2001 – 2008 Origination Years

	Conventional	Fannie Mae	Freddie Mac	Proposed Expanded QRM	Agency Alternative QRM	Agency QRM
2001	2.56%	**1.20%**	**0.80%**	0.81%	0.66%	0.48%
2002	1.98%	**1.10%**	**0.70%**	0.57%	0.48%	0.36%
2003	1.67%	**1.15%**	**0.60%**	0.58%	0.50%	0.39%
2004	3.05%	**2.20%**	**1.47%**	1.01%	0.88%	0.72%
2005	6.91%	**4.11%**	**3.30%**	1.96%	1.73%	1.49%
2006	11.86%	**6.85%**	**5.50%**	2.80%	2.47%	2.11%
2007	11.22%	**6.85%**	**5.60%**	3.07%	2.52%	1.94%
2008	3.62%	**1.70%**	**1.50%**	1.28%	1.00%	0.64%
2001-2008	**5.13%**	**2.83%**	**2.23%**	**1.19%**	**1.02%**	**0.81%**

C. QRM Market Reach

The NPR's QRM definitions will exclude a significant portion of potential home buyers from access to prudent and sustainable mortgages. MICA's Proposed Expanded QRM will perform well *and* significantly expands the availability of QRMs.[19]

- On average, only 17% of loans originated from 2001 – 2010 would have satisfied the agency QRM definition, and only 23% of those originations would have satisfied the alternative QRM definition.
- Looking only at 2009 and 2010, two years in which credit standards were considered to be extremely conservative, the agency QRM would have accounted for only 30% of originations.
- In contrast, 43% of originations would have qualified under MICA's Proposed Expanded QRM, looking at only 2009 and 2010.

While the recent financial crisis demonstrated that overly lenient underwriting standards result in some borrowers obtaining mortgages that are not sustainable, overly stringent standards are now preventing creditworthy borrowers access to mortgages and impeding the resolution of the housing crisis. Because the NPR QRM definitions are even more conservative, they will institutionalize overly restrictive standards, increasing the cost of credit and reducing access to the housing market for the bulk of first-time home buyers and all but the comparatively wealthy and cash rich. This is inconsistent with the policy intended by Congress under Dodd-Frank. Congress recognized the need for flexibility in underwriting and explicitly recognized that risk cannot be avoided in its entirety, but instead must be identified and managed prudently.[20]

To assess market impact of the various alternatives under consideration, MICA calculated the percent of 2001 – 2010 conventional mortgage market originations (as reflected in the CoreLogic Servicing Database) that would have satisfied the agency

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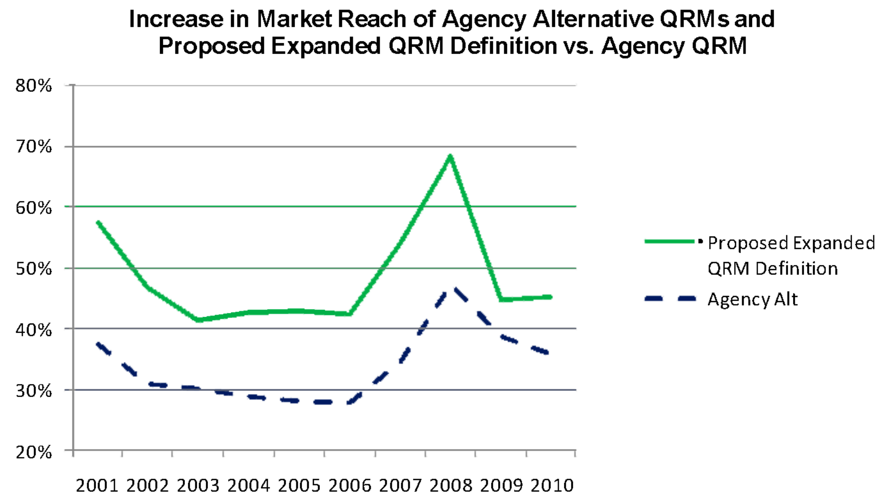
[19] Market shares calculated based on data on over 49 million loans originated from 2001 – 2010 included in the CoreLogic Servicing Database.

[20] The need for flexible underwriting standards and the importance of ensuring that underserved borrowers have access to prudent, affordable mortgages was highlighted during Senate debate on a proposed amendment to the Act that would have mandated a 5% down payment. Voicing his opposition to the proposal, Senate Banking Committee Chairman Chris Dodd stated "the [5% down payment requirement] puts in government-dictated, hard-wired underwriting standards that would have very serious consequences … for first-time home buyers, minority home buyers and others who are seeking to attain the American dream of home ownership … [I]t does this at a time … that the housing markets are just starting to recover, potentially putting that recovery at risk." 156 *Cong. Rec.* S3518 (May 11, 2010).

alternative QRM definition and the Proposed Expanded QRM definition. As seen in the graph below, while the agency alternative QRM definition would reach a greater portion of the market (approximately 34% more) than the agency QRM definition, the Proposed Expanded QRM definition reaches an approximately 46% greater share of the market than even the agency alternative.



The market impact of the agency QRM and the agency alternative QRM definitions are even more undesirable when one evaluates *which* borrowers will be excluded from these definitions. The NPR QRM proposals will adversely impact traditionally underserved markets and first-time home buyers. In 2010, approximately 86% of first-time home buyers would have been excluded by the 20% down payment requirement, and approximately 70% would have been excluded even if the down payment requirement was reduced to 10%. Median down payments in 2010 were 8%, with first-time home buyers averaging a 4% down payment.[21] Wide availability of low down payment loans is essential for first-time homebuyers. For example, it takes a family earning \$50,000 a year more than eleven years to save a 20% down payment on a \$153,000 home (the median priced existing house sold in the US in 2010).

Wide availability of low down payment loans also is necessary for the housing market recovery. As a result of the current housing downturn, many families who bought during the market boom have lost equity in their existing homes. Refinancing to a lower interest rate or shorter term loan becomes more difficult under the proposed QRM definitions in the NPR. People who bought homes in the past few years but now

[21] National Association of Realtors, *Profile of Home Buyers and Sellers 2010,* p. 71.

need to move for a new job or need a larger home for their family are at a disadvantage with a 20% minimum down payment requirement because they were not able to build equity as homeowners did in past years and may well have lost some or all of the equity they invested in their current home. These low down payment, repeat buyers and first-time homebuyers who need low-down payment options are a large part of today's housing market and are critical to the housing recovery. The National Association of Realtors estimates that 75% of all buyers – first-time buyers and repeat buyers – financed eighty percent or more of their home purchase in 2010.[22]

Without the continued availability of adequate, prudent private capital options for low-down payment lending, both first-time borrowers and repeat homebuyers will face limited financing options. As a result, many of these potential home purchasers will delay or end their attempt to buy a house and, as a consequence, the housing market recovery – already fragile – will falter or even fail.

D. A Narrow QRM will Raise Costs and Limit Borrower Choice

The narrow approach for QRM taken by the agencies will force virtually all low down payment lending toward other exemptions or exceptions – either to the FHA or (for the foreseeable future) to the GSEs. Borrower costs will be increased and borrower choice will be limited; private capital will be driven out of housing or discouraged from entering; and the role of the government – and the ultimate financial risk to taxpayers – will be maintained at its current elevated level of over 95% of all home loans.

Under the NPR the only way for a low down payment borrower to secure a loan, *regardless of that borrower's credit history or capacity to repay his or her loan*, will be via FHA, the GSEs (but only for so long as their guarantees are a permissible form of risk retention) or through a higher cost non-QRM that is subject to risk retention.[23] That is a poor outcome for borrowers, for housing markets and for taxpayers.

In many cases today, the cost to a borrower of an FHA loan exceeds the cost of a loan with MI. For example, a borrower purchasing a $250,000 home with a 10% down payment would pay thousands of dollars more (over the typical life of a mortgage loan) for a loan with

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[22] National Association of Realtors, *Profile of Homebuyers and Sellers, 2010*, p.71 Exhibit 5-3.

[23] Moody's Analytics estimates that the interest rate for non-QRM loans will rise by 75 – 100 basis points. See Mark Zandi and Cristian deRitis, *Reworking Risk Retention*, Moody's Analytics, June 20, 2011.

FHA insurance than for a comparable loan with MI.[24] But if low down payment loans are excluded from the definition of QRM, there will no longer be a lower cost MI option for that borrower (once the treatment of the GSE guarantee as risk retention expires). Loans with MI will be saddled with additional risk retention costs that could drive virtually all low down payment lending to the FHA– even loans to high quality, low risk borrowers. This housing policy approach runs the risk of driving MI companies, along with the private capital they invest in housing finance, from the market (or, at a minimum, discouraging the entry of new capital).[25] Such a development will leave borrowers with less choice and higher costs, and burden taxpayers with more housing market risk. This outcome belies the Administration's stated goals of decreasing the role of the Government in housing finance and returning to a market that is primarily capitalized by private sector investment. In their joint paper on reforming US housing finance released in February 2011, The Department of the Treasury and the US Department of Housing and Urban Development laid out a plan under which private markets "will be the primary source of mortgage credit and bear the burden for losses."[26] Lenders simply do not offer low down payment loans without additional security such as MI or FHA

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[24] Assumes property purchase price of $250,000, base note rate of 5% (5.375% if the loan is sold to a GSE and subject to their current loan-level pricing) and borrower FICO score of 680, resulting in monthly payment of $1947 for a loan with FHA insurance versus a monthly payment of $1897 for a loan with private mortgage insurance sold to a GSE. Also assumes borrower remains in the home for at least four years.

[25] Section 951(c) of Dodd-Frank required the Board of Governors of the Federal Reserve System to conduct a study of the combined impact on each class of asset-backed security of the new credit risk retention requirements, including their effect on increasing the market for federally-subsidized loans. The study is available at http://www.federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf. MICA believes that the study did not address the critical question of whether failure to recognize MI as a criterion for the QRM and as qualified risk retention for non-QRM loans in concert with the proposed exemption for FHA will block the return of private capital to mortgage markets that would otherwise occur if a more sensible definition of risk retention and the QRM were provided.

[26] See US Dept. of the Treasury and US Dept. of Housing and Urban Development, *Reforming America's Housing Finance Market: A Report to Congress*, February, 2011. Available at http://www.treasury.gov/initiatives/Documents/Reforming%20America's%20Housing%20Finance%20Market.pdf The agencies are of course familiar with the huge cost to taxpayers related to Fannie Mae and Freddie Mac. FHA already is exposing taxpayers to potentially significant liability. The fiscal year 2012 Administration budget projects that the FHA's insurance-in-force will increase 28% in the current fiscal year (FY2011) and 10% in the next fiscal year. Taxpayer exposure for FHA mortgages will be $1.253 trillion by September 30, 2012. Not treating privately-insured loans similarly to FHA-insured loans in the QRM could significantly increase that potential exposure. Policies that result in driving more borrowers to FHA and other Government insurance programs will significantly increase the US taxpayers' exposure instead of putting private capital at risk.

backing. There is no other alternative to MI (*i.e.,* one that is large enough and with the appropriate infrastructure to meet the demand for credit enhancement on loans currently being insured by FHA) for management of the credit risk associated with low down payment lending. If US housing policy wishes to emphasize private capital, the QRM definition must be considered in light of the FHA exemption.

The data clearly demonstrate that a QRM can be more broadly defined to promote the origination of high quality, prudent and sustainable mortgages to a diverse range of credit worthy borrowers without materially compromising the overall performance of QRMs. Requiring MI on high LTV loans assures borrowers a better chance of staying in their home because the MIs' interests are aligned with theirs. It creates "skin in the game," not only for the MI company (which has its own capital at risk in a first loss position), but also for the lender as a result of the MI companies holding the lender accountable for the integrity of their origination and servicing processes – thus protecting the investor. MICA's Proposed Expanded QRM definition, which includes greater borrower eligibility but expects default performance better than historical results for either the conventional private or Government-insured markets, achieves Congressional intent underlying the QRM concept.

MICA suggests that its proposed broader QRM be accompanied by specific eligibility requirements for MI companies (described in Section VI below) and counterparty financial integrity requirements established and monitored by state insurance regulators, the only group of financial regulators in the US with regulatory and supervisory experience regarding MI. See Appendix 2 for a discussion of MI regulation.

E. Junior Liens Should be Prohibited in QRM Loans

MICA agrees with the proposed ruling's prohibition against the use of junior liens in conjunction with a QRM loan.[27] In addition to the performance issues outlined in the NPR, junior liens have proven to be a major obstacle to loan modifications and other efforts at loss mitigation due to conflicts of interest and lack of alignment with the

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[27] See NPR page 24120. ("Thus, the proposed rules prohibit the use of a junior lien in conjunction with a QRM to purchase a home. Data indicate that, controlling for other factors, including combined LTV ratio, the use of junior liens at origination to decrease down payments—so-called "piggyback" mortgages—significantly increased the risk of default.[132]").

borrower. It would be poor policy to encourage widespread use of junior liens by including them within the final QRM definition.

III. Private Mortgage Insurance Should be an Eligibility Criterion for QRMs Because it Reduces the Frequency and Severity of Loss

This portion of the MICA response is directed to Questions 111a, 111b, and 111c of the NPR.

A. The NPR Applies an Inappropriate and Incomplete Measure of MI's Value

The legislative history of Dodd-Frank discussed above assumed the use of MI for low down payment loans included within the QRM definition. The agencies have taken a different approach regarding MI, which MICA believes is both inappropriate and incomplete. The agencies have argued that MI should be recognized only to the extent that it reduces the frequency of default. The agencies state that they "…. have not identified [adequate data] demonstrating that mortgages with credit enhancements such as (MI) are less likely to default than other mortgages…. Therefore, the Agencies are not proposing to include any criteria regarding …. (MI)."[28]

MICA believes the agencies' emphasis on reducing default frequency is misplaced. A formal default without loss (*e.g.* a late-paying borrower) is largely inconsequential to an investor even if the event happens multiple times. A default with loss does affect an investor because the loss needs to be allocated and absorbed, which is the primary role of MI. Indeed, the measure of effectiveness for any form of insurance is its ability to protect against or reduce the insured party's risk, and particularly its risk of loss. Thus, the standard applied by the agencies to measure MI's effectiveness is inappropriate. MI does reduce the frequency of default regarding low down payment loans (as shown below), but it is more appropriate to evaluate the value of MI based on its use in reducing the severity of losses to mortgage lenders and investors from defaults on their insured loans.

MICA's interpretation regarding the appropriate Dodd-Frank measure of MI's value is not controversial or self serving. It is in fact consistent with that of one of the agencies. The FDIC's legal justification for including loss mitigation provisions within the QRM definition rests in considerable part on its characterization of MI as a "…form of credit

[28] NPR at 24119.

support (that) …reduces the risk of default or the loss given default of the loan."[29] Thus, although MICA demonstrates below that MI reduces the frequency of default compared to uninsured low down payment loans, MICA suggests that legislative history and a functional approach to MI (as taken by the FDIC) requires full recognition of the value offered by MI in a revised QRM definition.

B. MI Satisfies the NPR Standard for Reducing Risk of Default

MICA discussed above its reasoning for interpreting the Dodd-Frank reference to MI reducing "the risk of default"[30] to mean the credit risk experienced by investors (*i.e.*, default + loss). In contrast, the agencies in the NPR restricted the measure of MI effectiveness to the simple incidence of default, explaining:

> While this insurance protects creditors from losses when borrowers default, the Agencies have not identified studies or historical loan performance data adequately demonstrating that mortgages with such credit enhancements are less likely to default than other mortgages, after adequately controlling for loan underwriting or other factors known to influence credit performance, especially considering the important role of LTV ratios in predicting default.[31]

Although MICA has requested that the agencies disclose the "variety of information and reports relative to such guarantees and credit enhancements"[32] used in developing its assessment of MI (and reaffirms this request here), we are not surprised that the Agencies are unable to identify specific studies because historically research on MI has not attempted to isolate the value of MI in reducing the frequency of default separately from its proven value in reducing losses. This is in no small part due the fact that low down payment loans (*i.e.*, >80% LTV) generally have mortgage insurance (whether MI, FHA or from another Government insurance/guarantee program) because of investor credit enhancement preferences or bank regulatory capital management, and not just for the credit underwriting value of mortgage insurance.[33]

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[29] See FDIC Office of General Counsel, "Legal Arguments Supporting Inclusion of Servicing Standards in Risk Retention" (Dec. 13, 2010) at 2, available at http://www.scribd.com/doc/45822085/FDIC-Legal-Arguments-for-Residential-Servicing-Standards.

[30] 15G(e)(4)(B)(iv).

[31] NPR at 24119.

[32] Id.

[33] The GSEs are required to obtain credit enhancement for loans with LTVs greater than 80%, and MI is the most commonly used of the three forms of credit enhancement (the others being lender recourse and participation agreements). See

The data needed to test the NPR measure of MI value comes primarily from the bubble era "piggyback" loan structure, in which a combination of a first mortgage, second mortgage and borrower down payment was used to avoid GSE credit enhancement requirements (a so-called "80/10/10" has an 80% LTV first mortgage, 10% second mortgage and 10% borrower down payment).[34] "Piggybacks" were used in sufficient number to create a pool of uninsured loans whose performance history can be compared against loans with MI.

Genworth Mortgage Insurance, a member of MICA, analyzed loan level data contained in the CoreLogic servicing data base to compare the performance of insured versus uninsured loans.[35] Genworth performed a tabular probability analysis of 4.9 million loans originated from 2003 - 2007, the results of which are included as Appendix 3. Controlling for origination year, geography, level of documentation, loan purpose, FICO score and CLTV, insured loans became seriously delinquent 32% less often than loans with piggyback seconds. Of loans that did become seriously delinquent, insured loans cured 54% more often than loans with piggyback seconds. As a result, borrowers with insured loans stayed in their homes 40% more often than those with piggyback seconds. The Genworth study was shared with the agencies prior to the publication of the NPR.

Based on the equivocal response to the Genworth study by the agencies, MI companies sponsored two independent studies which validated the conclusion that insured loans have substantially lower default incidence than uninsured loans after controlling for all other risk factors.

Independent Study 1: Promontory Financial Group

Genworth commissioned the Promontory Financial Group to conduct an independent analysis of low down payment loans in the CoreLogic data base, comparing the relative performance of insured and piggyback loans.[36] Promontory modeled defaults using a proven hazard

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e.g., Section 302(a)(2)(B)(3)(b)(2) of Fannie Mae Charter Act, available at http://www.fhfa.gov/GetFile.aspx?FileID=29. Federal bank capital regulation lowers the applicable risk weight for a high LTV residential mortgage loan carrying MI. See e.g., Interagency Guidelines for Real Estate Lending Policies, 12 C.F.R. 365, Appendix A at 623 (supervisory loan-to-value limits), available at http://edocket.access.gpo.gov/cfr_2010/janqtr/pdf/12cfr365AppA.pdf.

[34] NPR at 24120.

[35] The CoreLogic (NYSE: CLGX) servicing database encompasses more than 80% of the first-lien mortgages in the US. Further information regarding CoreLogic is available at www.corelogic.com.

[36] The Promontory study is attached as Appendix 4. Genworth has a more extensive summary of the Promontory study in its response to the NPR.

modeling framework, including important borrower and loan characteristics (*i.e.*, FICO score, CLTV, owner-occupied status, loan purpose and documentation) and economic factors (*i.e.*, home prices and interest/unemployment rates). The study found insured loans had a lower likelihood of default than uninsured loans, and the difference was statistically significant. For example, the following table shows default rates for a range of time periods since origination.

Estimated Baseline Cumulative Default Rates – Cumulative Proportion Defaulting by Selected Months

Type	Months					
	12	24	36	48	60	72
Insured	0.017	0.057	0.097	0.127	0.149	0.167
Non-Insured w/Piggyback	0.017	0.058	0.110	0.149	0.180	0.202
% Difference (Non-Insured Relative to Insured Loans)	***0%***	***2.09%***	***13.47%***	***17.40%***	***20.79%***	***20.98%***

The cumulative default rate for uninsured loans with piggyback seconds at 60 months (the time period used in the Milliman study below) and 72 months each was more than 20% greater than for comparable insured loans.

Independent Study 2: Milliman
MICA commissioned Milliman, a leading insurance and actuarial consulting firm, to do a comparative analysis of insured and uninsured loans using the same CoreLogic data set, a complete summary and the results of which are included as Appendix 5. Milliman performed a series of logistic regressions controlling for multiple factors, including:

- home price appreciation
- LTV
- presence of insurance
- FICO score
- property type
- loan purpose
- loan type
- originator type
- loan term
- relative property value

The results, displayed and discussed as a series of scenarios contained in the report, also confirm the beneficial effect of MI in reducing the likelihood of default. For summary purposes, however, the following table shows the relative differences of default rates and odds of default after 5 years for all uninsured loans compared to all insured loans by

CLTV and home price appreciation (HPA). Uninsured loans have from 31% to 94% greater likelihood of default than insured loans, with all differences exhibiting high statistical significance.

Default Rates: All Loans – Origination Years 2002 - 2006[37]

	CLTV 90	CLTV 95
HPA Range	**Insured Default Rate**	
HPA ≤ -20%	30.4%	33.5%
-20% < HPA ≤ 0%	10.9%	10.9%
0% < HPA ≤ 20%	5.8%	6.1%
20% < HPA	2.7%	3.4%
HPA Range	**Uninsured Default Rate**	
HPA ≤ -20%	53.8%	59.5%
-20% < HPA ≤ 0%	19.7%	18.4%
0% < HPA ≤ 20%	8.6%	8.0%
20% < HPA	3.8%	3.9%
HPA Range	**Difference of Uninsured to Insured Default Rate**	
HPA ≤ -20%	23.4%	26.0%
-20% < HPA ≤ 0%	8.8%	7.5%
0% < HPA ≤ 20%	2.8%	1.9%
20% < HPA	1.1%	0.5%
HPA Range	**Ratio of Uninsured to Insured Default Rate**	
HPA ≤ -20%	1.77	1.77
-20% < HPA ≤ 0%	1.80	1.69
0% < HPA ≤ 20%	1.48	1.33
20% < HPA	1.41	1.13
HPA Range	**Modeled Odds Relativity**	
HPA ≤ -20%	1.94	1.81
-20% < HPA ≤ 0%	1.53	1.37
0% < HPA ≤ 20%	1.45	1.40
20% < HPA	1.60	1.31

Two other results deserve mention:

- First, because much MI company business is related to GSE credit enhancement requirements and dependent on GSE purchase decisions, Milliman examined whether insured performance is better than uninsured performance on loans purchased by non-GSE investors. The Milliman results show a strong role for MI in reducing default incidence. Within this subset of loans the strong performance of MI-insured loans was clear across all house price appreciation scenarios but strongest when house prices fell. Additionally, the more significant the house price depreciation the greater the significance of MI

[37] Based on Table 3 of the Milliman study. Results shown are for "Terminated Loans Only" where, as described on page 15, "the ultimate performance of each loan is known as of the evaluation period of 20 quarters, which possibly imparts more stability in discerning statistical differences than the all loans model at any given evaluation period by reducing sample size and variation."

insurance and, MICA would argue, the greater the significance of the independent MI underwriting effect.[38]

- Second, because Congress intended MI to complement other parts of the QRM definition, Milliman examined whether insured performance is better than uninsured performance when a "QRM filter" was applied to privately purchased loans. The resulting analysis showed the strong impact of MI on privately purchased loans that otherwise met QRM requirements under every scenario except where house prices *increased* by more than 20% during the evaluation period. However, the impact of MI in this subset when house prices fell is significantly favorable for MI (*i.e.*, when the value of MI in avoiding default and reducing loss is magnified). Where house prices fell during the 5-year period the MI-insured privately purchased QRM qualifying loans performed two to almost four times as well as comparable uninsured loans. Even when house prices appreciated by less than 20% during the period the MI-insured loans performed almost twice as well as the uninsured loans.[39]

In conclusion, the report states[40]:

> **Milliman's results generally indicate loans with mortgage insurance at origination have historically been associated with a lower rate of default when compared to similar loans without mortgage insurance, after controlling for influential underwriting characteristics and economic trends.** This result is consistent across the five loan populations reviewed for this study. Loans with mortgage insurance showed the largest and most significant differences from uninsured loans in the negative HPA ranges. When applying the proposed QRM filters with the exception of LTV and DTI requirements, the results support the position that, if private mortgage insurance companies are not subject to pre-defined underwriting systems, loans with private mortgage insurance default at a lower rate than comparable loans without mortgage insurance.

[38] Milliman Study at page 13. The results are consistent with the less significant effect shown for MI in connection with GSE loans, where the strong influence of GSE automated underwriting systems (AUS) acts to blunt efforts by MI companies to provide independent underwriting regarding low down payment loans. MGIC discusses the influence of GSE AUS on MI underwriting in its response to the NPR.

[39] Id at page 14.

[40] Id at page 15(Emphasis added).

MICA invited Professor William Poole to do a peer review the Milliman Study.[41] Professor Poole noted the difference in default ratios between insured and uninsured loans. Beyond the general favorable performance of insured loans, Professor Poole drew attention to the superior performance of insured loans in environments characterized by declining house prices, reasoning that policymakers and portfolio managers should find value in an MI company's ability to identify loans less likely to default under stressful circumstances.

Collectively, these studies provide powerful evidence regarding the ability of MI to reduce default incidence. Moreover, the studies do this using the same database and three different but well accepted methodologies. In each study, insured loans have substantially lower default incidence than uninsured loans after controlling for all other risk factors. The magnitude of the effect is similar across all three studies as well. The studies clearly show that MI underwriting meets the Dodd-Frank test of reducing the "risk of default" as defined in the NPR. Thus, MICA respectfully requests that the agencies revise their initial assessment of MI included in the NPR and confirm MI as an element of the QRM definition in the final risk retention rule.

C. MI Also Reduces the Risk of Default by Helping to Prevent or "Cure" Foreclosures

MI reduces defaults and helps homeowners stay in their homes through loan modification and other efforts taken by the MI companies to prevent avoidable foreclosures. Mortgage insurers have a history of partnering with lenders, investors and community groups to work with borrowers in default. From 2008 through year-end 2010, mortgage insurers have facilitated efforts to help 645,000 borrowers with a total principal balance of $130 billion stay in their home, lower their interest payment or avoid foreclosure by participating in modifications, workouts and HARP refinances. These "cure" rates demonstrate yet another way in which MI "reduces the risk of default."

IV. MI-insured Loans Should be Exempt from Risk Retention

This portion of the MICA response is directed to Questions 162 and 173(a) of the NPR.

MICA discussed above the importance of recognizing the potential created by an unqualified exemption for FHA and other Government

[41] Professor Poole's full review is included as Appendix 6 to this comment.

insurance/guarantee programs to undermine the objectives of Section 941 regarding risk retention and to drive low down payment lending to the FHA. The Dodd-Frank Act permits the agencies to jointly adopt or issue exemptions, exceptions, or adjustments to the rules issued under Section 941. The agencies' authority is conditioned by the need to show that any exemption, exception, or adjustment given (1) helps ensure high quality underwriting standards for the securitizers and originators whose assets are securitized or available for securitization; and (2) encourages appropriate risk management practices by the securitizers and originators of assets, improves the access of consumers and businesses to credit on reasonable terms, or otherwise is in the public interest and for the protection of investors.[42]

Absent a broader QRM, MICA proposes creating an exempt category for loans (and by implication, securitizations) that use MI in order to preserve a meaningful outlet for non-government low down payment lending.[43] MICA urges this action for several reasons. MI, with its independent underwriting criteria, meets the statutory test of helping to ensure high quality underwriting standards and encourages appropriate risk management practices by securitizers and originators of assets by reducing the risk of default. MI companies also provide a unique level of process oversight – sometime described as a "second pair of eyes" – that can serve as an important check on third party errors, omissions and outright fraud and misrepresentation.[44]

MI also improves consumers' access to credit on reasonable terms and is otherwise in the public interest. Indeed, one of the strongest policy arguments for supporting a "level playing field" between MI and Government mortgage insurance (such as FHA and VA programs) rests on consumer choice. Having access to a full set of borrowing options, particularly when the access offers a less expensive MI alternative to the borrower, is in the public interest. It also reduces reliance on taxpayer-supported insurance options.

Additionally, there is no substantive difference between private MI and Government mortgage insurance which justifies the unequal treatment

[42] Section 15G(e)(1)-(2).
[43] Even a partial acceptance of MICA's QRM proposal underlines the need for this exemption. For example, the alternative definition of a QRM presented in the NPR (at 24129, Questions 143-49) would exclude more than 50% of the MI industry's recently underwritten business, largely for LTV reasons. Substantially all of the FHA's business is written at 95% or greater LTVs. Ignoring this reality is inconsistent with increasing (or even maintaining) the role of private capital in low down payment lending.
[44] Bond insurers do not provide the process oversight and loan-level focus offered by the MI industry, as evidenced by the numerous lawsuits arising from soured securitizations and contentions regarding the amount of underwriting diligence owed.

proposed by the NPR. Dodd-Frank simply exempts "any residential mortgage loan asset… which is insured or guaranteed by the United States or an agency of the United States".[45] The exemption is not dependent on underwriting standards or loan terms, and so by itself does not promote prudent underwriting. Neither the legislative history of Dodd-Frank nor any independent objective data have maintained the superiority of Government mortgage insurance from a credit risk management perspective. Indeed, longstanding interest regarding FHA reform is based on the perceived need to equip the FHA with the underwriting and risk management tools already used by MI companies. Because the FHA (and other Government mortgage insurance programs) exemption is a statutory one provided by Dodd-Frank, "leveling the playing field" requires regulatory action by the agencies.[46]

MICA's request regarding an exemption for MI is also important now that US housing policy favors increasing the role of private capital. Lenders simply do not offer low down payment loans without additional security such as MI or FHA backing. There is no other alternative to MI for management of the credit risk associated with low down payment lending. If US housing policy wishes to emphasize private capital, the treatment of MI must be considered in light of the FHA exemption.

MICA recognizes an exemption for loans insured by MI should be accompanied with suitable measures to ensure protection of investors, which is why we support the eligibility requirements outlined in Section VI below and counterparty financial integrity requirements established and monitored by state insurance regulators, the only group of financial regulators in the US with regulatory and supervisory experience regarding MI, as further detailed in Appendix 2.

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[45] 15G(e)(3)(B).

[46] NPR at 24136. The agencies suggest that loans insured by government MI and securitized by a private entity would be treated as exempt. NPR at 24137. MICA supports this reasoning even if it is extremely unlikely that a private securitizer would be willing to match Ginnie Mae's guarantee fee of 6 basis points. See Ginnie Mae Frequently Asked Questions, available at http://www.ginniemae.gov/media/ginnieFAQ.asp?Section=Media. However, MICA also urges the agencies to clarify that a securitization guaranteed by Ginnie Mae (*i.e.*, "the United States or any agency of the United States") that includes loans insured by MI also would qualify for exemption from risk retention. Such an alternative might offer attractive possibilities to reduce the role of Government MI in the US housing finance system.

V. MI Should Be Included as a Permissible Form of Risk Retention for Non-QRM Loans.

This portion of the MICA response is directed to Questions 69(a) and 90 of the NPR.

The Dodd-Frank Act created a variety of general and asset-specific forms of risk retention. Congress expressly provided for third parties to be treated as "risk retainers" in Dodd-Frank. Both the Treasury and Federal Reserve raised the possibility of third-party credit enhancement providers as "risk retainers" in their reports on risk retention required by Dodd-Frank. A first loss provider like MI has sufficient skin in the game to meet the incentive alignment with the originator, securitizer and investor as envisioned by Congress in the construction of Section 941 and should be considered as a permissible form of risk retention. In effect, MI offers a "thicker" (*i.e.*, 2-7 times more) form of horizontal risk retention than the 5% proposed in the NPR, and the retention is enhanced further by third-party oversight – providing a justification similar to that applied to the use of third-party risk-takers in commercial mortgage-backed securities.[47] Additionally, MI is structured to promote real skin in the game from loan originators and mortgage investors because MIs have in the past covered only 20% to 25% of the valid claim amount (generally equal to the outstanding loan balance plus certain foreclosure related expenses) which during periods of severely declining house prices does not cover the full loss after the loan is sold in foreclosure and the MI pays its agreed-upon claim amount.

Thus, MI should be allowed as an asset-specific form of risk retention, following the precedent set by third-party B-piece buyers of CMBS.

VI. MI Should be Subject to Eligibility Requirements

This portion of the MICA response is directed to Questions 112 and 151.

Including MI within the final risk retention rule as proposed by MICA requires MI to be a durable source of risk mitigation expertise and risk retention capacity. For this reason, MICA suggests recognition of "qualified MI". Qualified MI is defined as insurance covering the first loss exposure on a residential mortgage loan which meets the following criteria:

[47] NPR at 24109-11. The justifications used by the SEC in its economic analysis discussion of CMBS B-piece risk retention can be applied with equal force to the use of MI within the residential mortgage asset category. NPR at 24153.

- The MI company should be in good standing with its state domiciliary regulator. Within the context of a multi-state regulatory system, the domiciliary regulator asserts the most supervisory authority, receives the most financial and operating information, undertakes periodic financial/operational assessments and makes judgments on qualitative aspects not easily reduced to a "requirement". The domiciliary regulator is the linchpin of the state insurance regulatory system. Any business written outside the domiciliary jurisdiction requires a license, which allows regulators in those jurisdictions to impose additional prudential and market conduct requirements. Further description of the regulatory regime applicable to MI companies (including capital and reserves) is available in Appendix 2 to this response.
- Adequate MI coverage must be obtained. At a minimum 20% coverage must be obtained to cover the basic costs of a mortgage foreclosure (*i.e.,* accrual of unpaid interest, foreclosure fees, property maintenance, real estate disposition fees and legal fees). Customary coverage (also known as standard coverage)[48] provides coverage for normal foreclosure costs in addition to covering modest home price decline. Although not specified in the legislative history of Dodd-Frank, Congress likely was assuming standard coverage in its references to MI. "Deep coverage", or a greater level of insurance protection than that provided by standard coverage but less than the 100% protection provided by the FHA, also might be considered within the context of an expanded QRM definition for investor protection purposes. Deep coverage likely would cover substantially all the loss in most foreclosures, including those experienced in the ongoing housing market downturn.[49]

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[48] 35% for 97% LTV loans (bringing the initial exposure down to 63%), 30% for 95% LTV loans (exposure down to 66.5%), 25% for 90% LTV loans (exposure down to 67.5%), and 12% for 85% LTV loans (exposure down to 74.8%).

[49] See Milliman Client Report, *Mortgage Cohort Credit Loss Analysis as of September 2010,* April 1, 2011 prepared for Mortgage Insurance Companies of America in Appendix 7. This analysis analyzed the loan level pricing fees imposed by the GSEs on borrowers, which are supplemental to the MI insurance coverage on the subject loans. The study reviewed the performance of loans originated from 1998 through 2010. Part of this analysis determined the projected loss severity for loans subject to varying levels of deeper MI coverage with simulated average present value loss rates net of mortgage insurance varying from 0.88%, for loans with the current standard MI coverage, to 0.06% where deeper MI coverage sufficient to bring the initial LTV down to 35%, which indicates a significantly reduced risk of loss beyond current coverage levels to what may be considered essentially negligible loss rates.

- It is important to note that deeper MI coverage levels that bring the initial LTV below 60% will not undermine the incentive of the lender to originate loans that comply with the MI underwriting requirements at the time of origination. Failure by a lender to meet these requirements allows for rescission of the loan when a request for a claim payment is made to the MI. Similarly, unlike FHA insured loans, MI insured loans with deep coverage continue to put the lender at risk for losses on individual loans which exceed the coverage amount.
- The insured loan must have been underwritten according to the MI company's specified underwriting guidelines.

MICA's suggested combination of MI company regulatory compliance, minimum coverage levels and adherence to rigorous credit underwriting discipline ensures a higher standard than that available simply from specifying financial requirements for MI companies. MICA's suggestions assure robust incentive alignment with originators, securitizers and investors as well.

VII. GSE Guarantees Should be Recognized as Permissible Risk Retention

This portion of the MICA response is directed to Question 79.

MICA supports the NPR's provisions that make a guarantee by Fannie Mae or Freddie Mac a permissible form of risk retention under the conditions provided in the NPR.[50] The proposed GSE treatment is critical in practical terms given the centrality of the GSEs to the current housing finance system. The proposed treatment is defensible from a risk retention perspective as well. The risk retained by the GSEs under their guarantees to investors (coupled with conservatorship oversight and US Government financial support to assure investors that the guarantees are money-good) is consistent with the incentive alignment sought by the agencies in the NPR.

[50] NPR at 24111-12.

VIII. Hedging and Transfer Restrictions Should Concentrate on Incentive Effects

This portion of the MICA response is directed to Questions 80-81 and 96-105 of the NPR.

The NPR's proposed restrictions on hedging or transferring credit risk retained are broadly appropriate. MICA believes the agencies should clarify the intended purpose of the hedging/transfer restrictions as promoting positive incentive effects. To that end, MICA suggests the agencies require a documented justification or preapproval for any hedge or transfer proposed, and any hedging or transfer activity should be subject to anti-abuse standards. The suggested justification is based on the proposed "Credit Risk Retention" description proposed for the GSEs,[51] but making the description mandatory for all securitizers. The justification should include a clear statement that the hedging or transfer activity is not materially related to the credit risk required to be retained.[52] MICA recognizes the benefits of this process must be balanced against the burdens of compliance, so we would urge a menu of compliance alternatives (*e.g.*, preapproval and an after the fact justification could have different disclosure standards, and reviews could be done on a program basis).

Regarding the hedging and transfer provisions generally, MICA agrees that the issuing entity should not be considered a consolidated entity for purposes of applying the hedging restrictions. Specifically, MICA supports the reasoning presented in footnote 111 regarding MI, which is obtained at or shortly after origination and generates the positive incentive effects discussed elsewhere in this response.

Alternatively, MICA proposes a simpler approach to MI drawn from the European Union's counterpart legislation on credit risk retention, where MI is not considered to even be a hedge, but instead considered to be a "prudent element of credit-granting". Indeed, at a time when commentators have expressed growing concerns regarding the divergence between US and European Union positions on financial regulation,[53] MICA strongly commends the reasoning used in Article

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[51] NPR at 24112.

[52] NPR at 24116. Additionally, MICA suggests that agency guidance would be helpful to clarify the meaning of "materially related" and other terms likely to recur in the preparation and discussion of any proposed hedge or transfer.

[53] See, e.g., Morrison/Foerster, Transatlantic Navigation of Securitization Reforms: A Guide (May 10, 2011), available at: http://www.mofo.com/files/Uploads/Images/110510-Transatlantic-Navigation-of-Securitization-Reforms-A-Guide.pdf.

122(a) of the EU Capital Requirements Directive 2009/111/EC regarding MI:

> In securitizations of trade receivables, originators sometimes purchase external credit insurance as part of the normal operating business. Similarly, **mortgage guarantee insurance is sometimes taken out in respect of a pool of mortgage loans. Such types of insurance need not necessarily be considered to be "hedges" of the underlying exposures, if undertaken as a legitimate and prudent element of credit-granting, and if their usage does not create a specific differentiation between the credit risk of (or the alignment of interest between) the retained positions or exposures and those positions or exposures that are sold to investors**. For instance, mortgage guarantee insurance need not be considered a "hedge" when loans in the pool of mortgages securitized – and to which both the originator and investors are equally exposed – benefit from such insurance. However, it could be considered a hedge if the securitized exposures do not benefit from mortgage guarantee insurance, but the exposures retained on balance sheet under option (c) do benefit from mortgage guarantee insurance. Similar considerations should apply to other forms of guarantee or insurance from which the exposures or positions of a securitization may benefit.[54] (Emphasis supplied).

The EU approach regarding private MI concentrates on incentive effects, and for that reason represents an attractive possibility for use by the Agencies in the final risk retention rule.

IX. Procedural Considerations

MICA would like to raise an important concern regarding the process undertaken with this NPR. Specifically, sweeping regulations of this sort are subject to Executive Order 12866[55] and Executive Order 13563[56] with regard to actions by agencies of the executive branch. Further, on July 11, the President extended the rationale of Executive Order 13563 to independent agencies, including the FRB, FHFA and FDIC.[57] However, the NPR only addresses Executive Order 12866 in

[54] Paragraph 42 of Committee of European Banking Supervisors, Guidelines to Article 122a of the Capital Requirements Directive (December 31, 2010), available at http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf.

[55] Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993).

[56] Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011).

[57] Exec. Order No. 13,579, 76 Fed. Reg. 41,587 (July 14, 2011).

passing, noting that the Office of Management and Budget (OMB) has reviewed this issue and providing contact information from which to obtain HUD's analysis to the degree the NPR has a significant economic impact. HUD informed MICA that the NPR meets the conditions of economic significance under Sec. 3(f)(1) of Executive Order 12866 based on the rule itself, so nothing other than the NPR is available for review on HUD's electronic docket. Inasmuch as MICA is interested in understanding the agencies' rationale for its proposed treatment of MI, the summary dismissal of MI in the NPR falls short of the expectations created by the provisions contained in Executive Orders 12866, 13563 and 13579.

Although we understand that several Inspectors General have considered this issue following requests from Congress,[58] the NPR provides no indication of the degree to which the Executive Orders were met. Executive Order 13563 was issued earlier this year by President Obama (prior to the NPR) to ensure that federal rulemakings are transparent, especially with regard to the technical analyses on which they are premised. Executive Order 13579 urges the independent agencies involved in the NPR to act within the spirit of the earlier Orders. MICA would note that a critical issue in this NPR is the degree to which MI reduces the risk of default.[59] FHFA has provided public data on this point,[60] but the other agencies have failed to do so. MICA believes the FHFA analysis is flawed in numerous respects (most notably by FHFA data limitations since data derived from the government-sponsored enterprises lack necessary comparisons between

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[58] Board of Governors of the Federal Reserve System, Office of Inspector General, Response to a Congressional Request Regarding the Economic Analysis Associated with Specified Rulemakings (June 13, 2011), *available at* http://www.federalreserve.gov/oig/files/Congressional_Response_web.pdf; Securities and Exchange Commission, Office of Inspector General, Report of Review of Economic Analyses Performed by the Securities and Exchange Commission in Connection with Dodd-Frank Act Rulemakings (June 13, 2011), *available a*t http://www.sec-oig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf; Department of the Treasury, Office of Inspector General, Dodd-Frank Act: Congressional Request for Information Regarding Economic Analyses by OCC (June 13, 2011), *available at* http://www.treasury.gov/about/organizational-structure/ig/Documents/OIG-CA-11-006.pdf.

[59] Securities Exchange Act of 1934, section 15G(e)(4)(B)(iv) *as created by* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, section 941(b) (2010). The DC Circuit's assessment of the Commission's justifications for its actions in other regulatory matters suggests supplemental analysis might be merited regarding the Commission's economic analysis offered in the NPR. See fn 8 above and NPR at 24149-55.

[60] Patrick Lawler, *prepared testimony before the House Committee on Financial Services Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprise*s (Apr. 14, 2011) *available at* http://financialservices.house.gov/media/pdf/041411lawler.pdf.

comparable LTVs with or without private MI). If there are other data on which the agencies relied, these should be made public to inform final rulemaking on this critical issue.

Additionally, the NPR raises important issues regarding how and where the costs of the final rule might fall on current and prospective borrowers. The agencies have rightly sought views on this issue. MICA urges careful consideration of them, as well as consultation with OMB, to prevent any undue distributive impact of the final rule in violation of Executive Orders 13563 and 13579.

X. Conclusion

The MI industry has been a long-standing and vital part of the US housing finance industry. Not only does MI help families, many of whom are first-time buyers or lower-income borrowers, prudently buy homes, it protects investors by reinforcing originator and securitizer incentives to act properly and by reducing the frequency and severity of default. For the reasons and analysis provided in this response, MICA urges the agencies to incorporate the following recommendations in the final rule implementing Section 941 of Dodd-Frank:

1. Expand the QRM definition to include purchase and rate and term refinance loans up to 97% CLTV (with MI required on loans above 80% CLTV) and to include loans with a back-end debt-to-income ratio of up to 45%.
2. Maintain the prohibition against the use of a junior lien in conjunction with a QRM to purchase a home.
3. Exempt all mortgages backed by MI from risk retention.
4. Include qualified MI as a permissible form of risk retention for non-QRM loans.
5. Maintain the GSE exemption as proposed.
6. Clarify hedge restrictions.
7. Make all related agency analytics, research and reports public per applicable Executive Orders.

Sincerely,

Appendices:

1. Natter Report: *What Was the Legislative Intent behind the QRM?*

2. Regulatory and Capital Structure of Private Mortgage Insurance

3. Genworth Study: *MI Impact Analysis*

4. Promontory Study: *Assessing the Delinquency and Default Risk of Insured and Non-Insured High LTV Mortgages*

5. Milliman Study Addressing the Technical Analysis of the Role of Private Mortgage Insurance in Reducing the Frequency of Default: *Mortgage Insurance Loan Performance Analysis as of March 2011*

6. Review of Technical Analysis by Professor William Poole

7. Milliman Client Report, *Mortgage Cohort Credit Loss Analysis as of September 2010* (April 1, 2011), prepared for Mortgage Insurance Companies of America